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C O N F I D E N T I A L SECTION 01 OF 02 TOKYO 001337

SIPDIS

DEPT FOR EAP/J AND EEB/OIA
DEPT PASS USTR FOR CUTLER AND BEEMAN
TREASURY DEPT FOR DAS NOVA DALY, AND IA/CARNES
USDOC FOR 4410/ITA/MAC/OJ
NSC FOR TONG

E.O. 12958: DECL: 05/15/2013
TAGS: EINV ENRG PGOV OECD JA
SUBJECT: METI ORDERS TCI TO CANCEL J-POWER INVESTMENT PLANS

REF: TOKYO 1027 AND PREVIOUS

Classified By: EMIN Robert F. Cekuta, Reason 1.4 (b)

¶1. (SBU) Summary: The Ministry of Economy, Trade and Industry (METI) May 13 ordered The Children's Investment Master Fund (TCI), a U.K. hedge fund, to halt plans to double its 9.9 percent stake in electricity wholesaler Electric Power Development Company (J-Power). METI DDG Sasaki visited the Embassy May 13 to explain the GOJ's decision saying GOJ concerns center on the potential impact larger TCI shareholdings might have on J-Power's plans to build a pluthermal nuclear power plant. TCI continues to urge J-Power management to improve the company's corporate governance and financial performance and is taking the fight directly to fellow shareholders. End Summary.

¶2. (C) METI Deputy Director General for Trade and Economic Cooperation Nobuhiko Sasaki came to the Chancery with other METI officials May 14 to meet with EMIN and discuss the GOJ's decision. Sasaki said the GOJ had closely and seriously examined TCI's responses to the government's recommendation to halt plans to increase its J-Power shareholdings (ref). However, nothing in TCI's submission removed the government's concerns that TCI's further acquisition of J-Power shares posed a potential "risk to public order" -- meaning in this case the stable supply of electric power and continuation of projects critical to Japan's nuclear fuel cycle policy. The GOJ worries TCI's demands for J-Power to set firm targets of 10 percent return-on-equity (ROE) and 4 percent return-on-assets (ROA) would drain the firm's capital investment and repair and maintenance budgets and adversely affect construction of the Ohma pluthermal nuclear power plant, scheduled to begin operation in 2012. According to Sasaki, TCI failed to provide adequate assurances it would not block the plant's construction schedule. The GOJ took particular note of TCI's action in other cases. He said as a major shareholder in Deutsche Boerse, TCI had undercut the Boerse's attempt to buy the London Stock Exchange. He also pointed to TCI involvement in the sale of ABN Amro Bank. In both cases, Sasaki said, while still a minority shareholder,

TCI had been able to keep management from proceeding with strategic acquisitions.

¶3. (C) Sasaki repeatedly said Japan's policy of welcoming inward foreign investment, including by investment funds, is unchanged. This is the first time the GOJ had blocked a proposed share acquisition under the Foreign Exchange Law. Nor does the GOJ's decision in this case mean the GOJ opposes any foreign investment greater than 10 percent in J-Power. This case is unique, Sasaki stressed. While appreciating Sasaki's initiative in briefing the Embassy on the decision, EMIN noted USG officials and international markets have monitored the TCI/J-Power case closely. This decision follows the debate earlier in the year over whether to allow foreigners to invest in Japan's airport operators and the remarks by METI Vice Minister Kitabata over the role shareholders should play. Coming on top of the years during which Japan discouraged inward foreign investment, these events have added to skepticism regarding GOJ intentions toward FDI, something Sasaki also knew from the international press as well as from his discussions with U.S. and other foreign officials.

¶4. (SBU) A lawyer for TCI told EconOff May 13 the Fund is still considering its options, but is likely to challenge the GOJ's action in court. METI also expects a lawsuit but, under Japan's Administrative Procedures Act, according to Sasaki, TCI must first lodge an administrative appeal with the relevant government agency of the order before TCI can go to court.

¶5. (SBU) TCI executives have publicly criticized the GOJ for a lack of transparency in its decision making. They insist TCI poses no risk to J-Power's financial stability or to Japan's national security. TCI's lawyer, in fact, told econoff TCI's demand for a higher dividend would cost the company only about USD 100 million, less than 10 percent of J-Power's USD 1 billion in planned capital investment over the next three years.

¶6. (SBU) Even without the expanded stake, TCI continues to pursue aggressively efforts to improve J-Power's financial fundamentals. On April 26, the Fund submitted five shareholder proposals for consideration at J-Power's June annual general meeting. Two proposals call for dividend hikes, of either 80 yen or 120 yen, up from the current 60 yen per share. TCI recommends the payouts be paid, in part, by reducing the company's 68 billion yen (USD 660 million) in cross-shareholdings to no more than 5 billion yen (USD 48 million). TCI also wants the company to use up to 70 billion yen to buy back its own, undervalued, shares. The final proposal would require J-Power's board to appoint at least three new independent directors to its sixteen member board. J-Power's management opposes all five proposals, setting the stage for a proxy fight next month. As a compromise, J-Power's board has asked shareholders to approve a new 70 yen per share dividend.

Comment

¶7. (C) While TCI argues there has been a lack of transparency in the case, METI and the Ministry of Finance (MOF) together have conducted six separate hearings with TCI representatives since January and MOF's Advisory Council held two further hearings. The two sides also met informally on a number of occasions. In terms of substance, there is an impression that the two sides have been talking past each other. TCI seems unwilling to acknowledge the GOJ's strong interest in the Ohma project and unwilling to provide assurances it will not seek to derail that project -- something Sasaki told us was a key factor in the GOJ's decision. The GOJ, however, fails to appreciate that TCI's corporate governance proposals and ROE/ROA targets likely

would strengthen, not weaken, J-Power's financial position and the cost of those measures could easily be covered by better management of J-Power's cash assets and unwinding most of its non-productive cross-shareholdings. Such steps would seem largely to eliminate the risk of electricity tariff hikes or cutbacks in the company's maintenance budget the GOJ says it fears.
DONOVAN